

## Message Text

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AMCONSUL QUEBEC

C O N F I D E N T I A L SECTION 1 OF 5 MONTREAL 68

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E. O. 11652: GDS  
TAGS: PFOR, CA  
SUBJ: STUDY OF IMPACTS OF PQ ELECTION

REF: 76 STATE 303089

1. REFTTEL ASSIGNED MONTREAL RESPONSIBILITY FOR THE ECONOMIC SITUATION IN QUEBEC OVER THE NEXT FIVE YEARS UNDER THE GENERAL RUBRIC OF A STUDY OF THE IMPACT OF PQ ELECTION. FOR SOME TIME THERE HAVE BEEN TRENDS IN THE QUEBEC ECONOMY WHICH WOULD INFLUENCE ITS PERFORMANCE OVER NEXT FIVE YEARS, WITH OR WITHOUT PQ GOVERNMENT. SOME OF THESE TRENDS ARE RESULTS OF "FRANCIZATION" OF QUEBEC, AND FEAR OF EVENTUAL PQ TAKEOVER, WHILE OTHERS REFLECT ECONOMIC FACTORS MORE CLOSELY RELATED TO STRUCTURAL PROBLEMS FACED BY CANADA'S ECONOMY AS A WHOLE, AS WELL AS THE CONTINUING SHIFT OF CANADA'S ECONOMIC LOCUS TOWARDS THE CENTER AND AWAY FROM QUEBEC. AS ANY ANALYSIS OF QUEBEC'S ECONOMIC SITUATION OVER NEXT FIVE YEARS MUST OBVIOUSLY TAKE PRESENT STRUCTURE AND TRENDS INTO ACCOUNT, WE HAVE INCLUDED SECTIONS CONTAINING RELEVANT INFORMATION FOR POSSIBLE USE BY WASHINGTON  
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AGENCIES IN CONSIDERATION OF FINAL FORM OF STUDY. ALSO, AS IMPONDERABLES AND VARIATIONS RELATING TO QUEBEC'S OPTIONS UNDER SEPARATION ARE TOO NUMEROUS TO ELABORATE, WE HAVE CONFINED COMMENTS TO THE MOST BASIC SCENARIOS, WHICH WILL PROVIDE THE CONCEPTUAL FOUNDATION FOR QUEBEC'S ALTERNATIVES.

2. SETTING: IMPORTANCE AND NATURE OF QUEBEC'S ECONOMY - QUEBEC IS CANADA'S SECOND WEALTHIEST PROVINCE, RANKING BEHIND ONTARIO. GROSS PROVINCIAL PRODUCT IN 1975 TOTALLED \$38.8 BILLION, EQUAL TO 24 O/O OF CANADA'S GROSS NATIONAL PRODUCT. FOR 1975, ONTARIO'S GROSS PROVINCIAL PRODUCT TOTALLED \$65.3 BILLION, EQUAL TO 41 O/O OF CANADA'S GROSS NATIONAL PRODUCT. ON A PER CAPITA BASIS, PERSONAL INCOME IN QUEBEC IN 1975 AMOUNTED TO \$4,683, BELOW BOTH ONTARIO (\$5,620) AND THE CANADIAN NATIONAL AVERAGE (\$5,106).

3. TOTAL CANADIAN MANUFACTURED GOODS SHIPPED DURING 1975 TOTAL \$85.2 BILLION. OF THIS TOTAL, QUEBEC ACCOUNTED FOR \$23.3 BILLION, OR 27.39 O/O. OF CANADA'S EXPORTS TO THE U.S., VALUED AT \$20.9 BILLION IN 1975, QUEBEC PROVIDED ABOUT \$3.5 BILLION, OR 17 O/O. WHILE IT IS DIFFICULT TO OBTAIN COMPLETE FIGURES, U.S. INVESTMENTS IN QUEBEC ARE ESTIMATED AT FROM \$4 TO \$5 BILLION, ABOUT 15 O/O OF TOTAL U.S. DIRECT INVESTMENT IN CANADA (\$28.4 BILLION). QUEBEC'S SHARE OF CANADA'S GROSS FIXED CAPITAL FORMATION IS SLIGHTLY OVER 20 O/O. IN TERMS OF RESOURCES, QUEBEC IS AN IMPORTANT SUPPLIER OF IRON ORE, ASBESTOS (QUEBEC IS THE WORLD'S LEADING SUPPLIER OF ASBESTOS), COPPER ORE, ALUMINUM, AND PULP, PAPER AND NEWSPRINT. A MAJOR ASSET IS THE AVAILABILITY OF CHEAP HYDRO-ELECTRIC POWER, SOME OF WHICH QUEBEC PLANS TO EXPORT TO THE U.S. IN THE FUTURE.

4. QUEBEC'S ECONOMY IS DIVERSIFIED, WITH THE SERVICES SECTOR ACCOUNTING FOR THE LARGEST PROPORTION OF QUEBEC'S OUTPUT. GROSS DOMESTIC PRODUCT FOR THE PROVINCE, CONFIDENTIAL

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MEASURED ON THE BASIS OF VALUE ADDED, SHOWS THE FOLLOWING SECTOR BREAKDOWN AS A PERCENTAGE OF TOTAL GROSS DOMESTIC PRODUCT: PRIMARY SECTION, 4.5 O/O; SECONDARY SECTOR, 34.9 O/O; SERVICES SECTOR, 60.6 O/O. MANUFACTURING AND SERVICE INDUSTRIES ARE THE MOST IMPORTANT SUB-SECTORS, ACCOUNTING RESPECTIVELY FOR 24.9 O/O AND 21.4 O/O OF GROSS DOMESTIC PRODUCT. TRADE, 13.5 O/O AND FINANCE, INSURANCE AND REAL ESTATE, 11.3 O/O, ARE THE ONLY OTHER SUB-SECTORS ACCOUNTING FOR MORE THAN 10 O/O OF DOMESTIC PRODUCT.

5. A BREAKDOWN OF QUEBEC'S ECONOMY ON AN EMPLOYMENT BASIS SHOWS BASICALLY THE SAME COMPOSITION, WITH THE ONLY SIGNIFICANT DIVERGENCE BETWEEN THE EMPLOYMENT AND COST OF FACTOR APPROACHES OCCURRING IN FINANCE, INSURANCE AND REAL ESTATE, WHERE THE CONTRIBUTION ON A FACTOR COST BASIS IS ABOUT 7 PERCENTAGE POINTS HIGHER THAN ON A LABOR BASIS, AND IN SERVICES INDUSTRIES, WHERE THE CONTRIBUTION ON A LABOR BASIS IS ABOUT 6 PERCENTAGE POINTS HIGHER THAN ON A FACTOR COST BASIS.

6. QUEBEC'S INDUSTRY IS ORIENTED TOWARDS RAW MATERIALS AND LABOR INTENSIVE INDUSTRIES. MEASURED ON THE BASIS OF VALUE ADDED BY SECTOR, THE FOLLOWING INDUSTRIES ARE THE MOST IMPORTANT: TEXTILES AND CLOTHING, 16.4 O/O; PRIMARY METALS AND MANUFACTURING, 14.3 O/O; FOOD AND BEVERAGES, 13.4 O/O; AND PAPER, 9.4 O/O. A COMPARISON WITH ONTARIO'S INDUSTRIAL STRUCTURE SHOWS GREATER QUEBEC CONCENTRATION IN TEXTILES, AND PAPER AND WOOD, WHILE ONTARIO IS MORE HIGHLY CONCENTRATED IN TRANSPORTATION EQUIPMENT AND MACHINERY. FOR QUEBEC, FOOD AND BEVERAGES, PAPER, PETROLEUM AND COAL PRODUCTS, PRIMARY METALS, AND TRANSPORTATION EQUIPMENT ACCOUNTED FOR SLIGHTLY OVER 50 O/O OF THE PROVINCE'S VALUE OF MANUFACTURERS' SHIPMENTS.

7. SALIENT CHARACTERISTICS AND TRENDS  
THERE ARE A NUMBER OF TRENDS IN QUEBEC'S ECONOMY WHICH ARE CONFIDENTIAL

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RELEVANT IN THINKING ABOUT QUEBEC BOTH IN A CANADIAN AND INDEPENDENT CONTEXT.

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8. - CANADA'S COMMERCIAL POLICY HAS BEEN A MAJOR FACTOR

IN SHAPING QUEBEC'S PRESENT ECONOMIC STRUCTURE. WHILE TARIFF PROTECTION FOR THE CANADIAN ECONOMY AS A WHOLE IS CONSIDERED HIGH RELATIVE TO OTHER DEVELOPED COUNTRIES, THE DEGREE OF PROTECTION AFFECTING QUEBEC INDUSTRY IS EVEN HIGHER. QUEBEC EMPLOYMENT ACCOUNTS FOR OVER 60 O/O OF TOTAL CANADIAN EMPLOYMENT IN INDUSTRIES PROTECTED BY TARIFFS OF OVER 20 O/O (THE PERCENTAGE FOR ONTARIO IS 28.8 O/O). MORE THAN ONE-HALF OF MANUFACTURING EMPLOYMENT IN QUEBEC IS IN INDUSTRIES WITH TARIFF PROTECTION IN EXCESS OF 10 O/O. SUCH INDUSTRIES ACCOUNT FOR ABOUT 40 O/O OF EMPLOYMENT IN OTHER AREAS OF CANADA. GIVEN THE HIGH DEGREE OF PROTECTION AND QUEBEC'S IMPORTANCE AS A MANUFACTURING CENTER, CANADA'S TARIFF POLICY HAS HAD THE EFFECT OF REDISTRIBUTING INCOME FROM OTHER PARTS OF CANADA TO QUEBEC.

9. - OF ALL THE PROVINCES, QUEBEC HAS THE GREATEST DEGREE OF DEPENDENCE ON CANADIAN MARKETS. 37 O/O OF QUEBEC'S MANUFACTURING EMPLOYMENT IS DEPENDENT ON EXPORTS TO OTHER CANADIAN REGIONS. (THE CORRESPONDING FIGURE FOR ONTARIO IS 27 O/O). FORTY THREE PERCENT OF MANUFACTURING EMPLOYMENT  
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IS DEPENDENT UPON THE LOCAL MARKET (49 O/O FOR ONTARIO), AND 20 O/O IS DEPENDENT ON PRODUCTION FOR FOREIGN COUNTRIES (24 O/O FOR ONTARIO). DEPENDENCE ON OTHER PROVINCIAL MARKETS HAS IMPLICATIONS WHICH WILL HAVE TO BE TAKEN INTO CONSIDERATION WHEN THE COSTS OF SEPARATION ARE WEIGHED.

10. - RECENT TRENDS INDICATE THAT GROWTH IN CANADIAN PRODUCTIVITY HAS LAGGED BEHIND THAT IN THE U.S. IN ADDITION, THERE ARE SOUND REASONS TO BELIEVE THAT QUEBEC HAS LOST GROUND IN A COMPETITIVE SENSE TO BOTH THE REST OF CANADA AND THE U.S., AS A WEAK INVESTMENT SECTOR HAS TENDED TO ERODE THE PRODUCTIVE BASE, AND WAGE INCREASES IN QUEBEC HAVE REGISTERED RELATIVELY HIGHER RATES OF INCREASE THAN SETTLEMENTS ELSEWHERE IN CANADA, AND IN THE U.S. FURTHERMORE, QUEBEC'S ECONOMIC STRUCTURE ENCOMPASSES A NUMBER OF LABOR INTENSIVE INDUSTRIES WHOSE COMPETITIVE POSITION IN THE PAST WAS ASSISTED BY A COMPARATIVE WAGE ADVANTAGE. RECENT INCREASES IN WAGES, HOWEVER, HAVE IMPAIRED QUEBEC'S ABILITY TO COMPETE EVEN IN LABOR INTENSIVE INDUSTRIES.

11. - DESPITE THE PROTECTION AFFORDED QUEBEC INDUSTRY, THE PROVINCIAL DISTRIBUTION OF VALUE ADDED IN GOODS PRODUCING SECTORS IS SHIFTING AWAY FROM QUEBEC IN FAVOR OF ONTARIO, BRITISH COLOMBIA, AND ALBERTA. QUEBEC'S SHARE OF CANADA'S CAPITAL INVESTMENT HAS DECLINED, AND MANUFACTURING INVESTMENT HAS BEEN WEAK. CAPITAL EXPENDITURES IN MANUFACTURING IN QUEBEC FELL IN 1976 BY 4.7 O/O, AFTER A FALL OF 1.7 O/O IN 1975, WHILE MANUFACTURING INVESTMENT FOR CANADA AS A WHOLE

IS ESTIMATED TO HAVE INCREASED BY 6.3 O/O IN 1976. IF THE EFFECTS OF INFLATION ARE TAKEN INTO ACCOUNT, WITH INCREASED FUNDS NEEDED TO REPLACE EQUIPMENT AT MUCH HIGHER UNIT COSTS, THE EXTENT OF THE DECLINE IN QUEBEC IS ACCENTUATED.

12. - CAPITAL WHICH IS BEING INVESTED IN QUEBEC HAS BEEN DRAWN, TO A GREATER RELATIVE EXTENT THAN IS TRUE ELSEWHERE IN CANADA, TOWARD INVESTMENT IN REAL ESTATE AND PUBLIC SECTOR  
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ACTIVITIES. CONSTRUCTION HAS INCREASED AS A MAJOR ACTIVITY IN QUEBEC'S ECONOMY, AND THE PROPORTION OF PUBLIC PROJECTS IN TOTAL CONSTRUCTION ACTIVITY HAS BEEN A MAJOR INPUT. OVER THE LAST SEVERAL YEARS, FULLY 50 O/O OF CONSTRUCTION EXPENDITURES WERE ASSOCIATED WITH PUBLIC PROJECTS, SUCH AS JAMES BAY, THE OLYMPICS, AND MONTREAL'S METRO.

13. - QUEBEC'S NATURLA POPULATION INCREASE IS ONE OF LOWEST IN CANADA. QUEBEC'S POPULATION AS A PERCENTAGE OF TOTAL CANADIAN POPULATION HAS FALLEN OVER LAST TEN YEARS FROM NEARLY 29 O/O TO A PRESENT LEVEL OF ABOUT 27 O/O. SINCE 1964, THE TREND HAS BEEN STEADILY DOWNWARD.

14. - WHILE QUEBEC'S RATE OF POPULATION INCREASE IS LOW, THE INCREASE IN QUEBEC'S LABOR FORCE DUE TO ENTRY OF WOMEN AND YOUTHS SEEKING EMPLOYMENT IS INCREASING AT A FASTER RATE THAN THE ECONOMY'S ABILITY TO PROVIDE JOBS. OVER THE LAST FOUR YEARS, THE LABOR FORCE HAS GROWN AT A COMPOUND RATE OF 3.2 O/O WHILE EMPLOYMENT HAS GROWN AT A RATE OF 3.0 O/O.

15. - QUEBEC NOW HAS ONE OF THE HIGHEST UNEMPLOYMENT RATES IN CANADA, ACCOUNTING FOR THE PREDOMINANT SHARE OF INCREASE IN CANADA'S UNEMPLOYMENT FIGURES. QUEBEC'S UNEMPLOYMENT RATE AT YEAR END STOOD AT 9.8 O/O, COMPARED WITH 6.2 O/O FOR ONTARIO AND 7.5 O/O FOR CANADA AS A WHOLE. WHILE THERE ARE POSSIBILITIES OF FUTURE LABOR SHORTAGES IN SOME AREAS OF CANADA, THE SITUATION IN QUEBEC, GIVEN A LESS THAN PROMISING ECONOMIC OUTLOOK, IS LIKELY TO WORSEN, EXACERBATING THE DIVERGENCIES IN REGIONAL EMPLOYMENT OPPORTUNITIES. MOREOVER, AN IMPORTANT ELEMENT IN QUEBEC'S LABOR MARKET HAS BEEN THE PREDOMINANCE OF MONTREAL AS A FINANCIAL AND SERVICES SECTOR. FOR A NUMBER OF YEARS, THERE HAS BEEN A STEADY MOVEMENT OF THESE SERVICES FROM MONTREAL TO ONTARIO. PRESENT SIGNS SUGGEST THIS MOVEMENT WILL ACCELERATE, WITH ATTENDANT SERIOUS IMPLICATIONS FOR  
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QUEBEC'S EMPLOYMENT SITUATION. THE SITUATION IS FURTHER COMPLICATED BY THE FACT THAT QUEBEC'S LABOR FORCE IS CHARACTERIZED BY A DEGREE OF STRUCTURAL RIGIDITY NOT PRESENT IN THE OTHER PROVINCES. DUE TO CULTURAL AND LINGUISTIC TIES, QUEBEC LABOR IS LESS RESPONSIVE TO EMPLOYMENT OPPORTUNITIES OUTSIDE QUEBEC.

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16. - RESIDENTS OF QUEBEC ARE NOW THE HIGHEST TAXED OF CANADA'S CITIZENS. THIS RESTRICTS THE GOVERNMENT'S ABILITY TO INCREASE TAXES AS A SOURCE OF REVENUE. AT THE SAME TIME QUEBEC IS APPROACHING A POINT WHERE ITS TOTAL DEBT LOAD MAY BEGIN TO PRESENT PROBLEMS, AND IT HAS A NEW GOVERNMENT WHICH HAS PROMISED TO IMPLEMENT NEW SOCIAL MEASURES WHICH, IF CARRIED OUT, WILL RESULT IN ADDITIONAL COSTS FOR THE GOVERNMENT. IN RECENT YEARS, QUEBEC HAS TURNED INCREASINGLY TO FOREIGN MARKETS AS A SOURCE FOR FINANCING, BOTH BECAUSE OF THE MAGNITUDES OF CAPITAL INVOLVED, AND THE AVAILABILITY OF LOWER INTEREST RATES. FOLLOWING ELECTION OF THE PARTI QUEBECOIS, INTEREST RATES ON QUEBEC ISSUES HAVE INCREASED, WIDENING THE SPREAD WITH ONTARIO.

17. NEAR TERM OUTLOOK  
THE IMPACT OF THE PQ ELECTION, OVER THE NEAR TERM, MUST BE VIEWED IN LIGHT OF PRESENT ECONOMIC TRENDS AND THE ECONOMIC AND POLITICAL ENVIRONMENT, BOTH PROVINCIAL

AND NATIONAL. EVEN WITH BUOYANT EXPECTATIONS FOR THE CANADIAN AND U.S. ECONOMIES, QUEBEC WOULD BE IN TROUBLE, GIVEN THE FACTORS MENTIONED IN THE PRECEDING SECTION.  
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FACED WITH THE LIKELIHOOD OF A SLUGGISH CANADIAN ECONOMY AND THE ELECTION OF A GOVERNMENT WHICH HAS CREATED NEW UNCERTAINTIES, QUEBEC'S PROBLEMS WILL CERTAINLY BE EXACERBATED.

18. WHAT IS NEEDED TO TURN QUEBEC'S ECONOMY AROUND IS INVESTMENT, IN TURN DEPENDENT ON BUSINESS CONFIDENCE AND A FAVORABLE ECONOMIC OUTLOOK. NEITHER IS PRESENT IN QUEBEC TODAY. EVEN IF THE POLICIES OF THE PQ GOVERNMENT WERE DESIGNED TO CREATE CONFIDENCE, THE NEXT SEVERAL YEARS ARE LIKELY TO CONTINUE TO BE CHARACTERIZED BY SOME UNCERTAINTY AND A WAIT-AND-SEE ATTITUDE ON THE PART OF THE BUSINESS COMMUNITY AND INVESTORS PENDING SOME FORM OF RESOLUTION OF THE QUEBEC INDEPENDENCE ISSUE.

19. IN ADDITION TO THE UNCERTAINTY RELATING TO THE FUTURE STATUS OF QUEBEC, THERE ARE OTHER FACTORS WHICH MILITATE AGAINST A FAVORABLE ECONOMIC PERFORMANCE AT THIS TIME. AMONG THE MOST IMPORTANT ARE LABOR DIFFICULTIES, THE PUSH OF NATURAL MARKET FORCES TOWARD ONTARIO AND AWAY FROM QUEBEC, AND BOTH PRESENT AND POTENTIAL GOVERNMENT POLICIES IN THE AREA OF LANGUAGE AND EDUCATION, INDUSTRIAL DEVELOPMENT, AND NATIONALIZATION. ALL ENCOURAGE A SHELIVING OF NEW EXPENDITURES UNTIL SOME CLARIFICATIONS ARE AVAILABLE.

19. PAST INVESTMENT IN QUEBEC WAS RESPONSIVE BOTH TO WAGE DIFFERENTIALS, WHICH WERE FAVORABLE, AND TO A TARIFF STRUCTURE WHICH BENEFITED QUEBEC AT THE EXPENSE OF OTHER AREAS IN CANADA. WITH THE RAPID RUN UP IN WAGE LEVELS IN QUEBEC, THE MOST RECENT DEVELOPMENT BEING AN INCREASE IN THE MINIMUM WAGE TO \$3 EFFECTIVE JANUARY 1, THERE ARE NO LONGER REAL LABOR COST ADVANTAGES TO INVESTING IN QUEBEC. MOREOVER, THE POSSIBILITY OF SEPARATION RAISES QUESTIONS ABOUT THE AVAILABILITY OF FUTURE MARKETS AND THE FUTURE FORM OF PROTECTION FOR QUEBEC INDUSTRY.

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20. WHILE THE IMPACT OF INCREASED LABOR COSTS CAN BE MINIMIZED IN RESOURCE INTENSIVE INDUSTRIES, LABOR PROBLEMS HAVE NOT BEEN CONFINED TO WAGE INCREASES. THEY HAVE INCLUDED

EXTENDED STRIKES AND WORK STOPPAGES, WHICH HAVE DAMPENED ACTIVITY THROUGHOUT THE QUEBEC ECONOMY. ONE OF THE FEW OPTIMISTIC NOTES IS A GENERAL BELIEF THAT LABOR RELATIONS UNDER THE PQ GOVERNMENT MAY IMPROVE. NONETHELESS, FEW FIRMS ARE WILLING TO BASE EXPENDITURES ON WHAT MAY PROVE TO BE A FALSE HOPE, GIVEN THE OTHER UNCERTAINTIES, UNLESS THEY HAVE TO. (CANADIAN INDUSTRIES LIMITED, FOR EXAMPLE, HAS SAID PRIVATELY THAT IT HAS TOO MUCH ALREADY INVESTED HERE TO CURTAIL SIGNIFICANTLY FUTURE INVESTMENTS.)

21. MOREOVER, THE NEW GOVERNMENT HAS MADE A SERIES OF STATEMENTS WHICH HAVE RAISED QUESTIONS ABOUT FUTURE GOVERNMENT POLICIES AND ATTITUDES TOWARD BUSINESS INVESTMENT. THE PLATFORM OF THE PARTI QUEBECOIS HAS LONG INCLUDED PROVISIONS FOR NATIONALIZATION IN SOME ECONOMIC SECTORS, SUCH AS THE ASBESTOS INDUSTRY. RECENTLY, PREMIER LEVESQUE MENTIONED COMMUNICATIONS, BASIC FINANCIAL INSTITUTIONS, AND SOME SPECIFIC INDUSTRIES "LIKE ASBESTOS", AS AREAS IN WHICH QUEBEC WOULD WANT HOME OWNERSHIP. RECENT STATEMENTS ON MODIFICATIONS AND AN ACCELERATION IN THE PRESENT PROGRAM OF FRANCIZATION HAVE ALSO CREATED UNCERTAINTIES. COMBUSTION ENGINEERING RECENTLY ANNOUNCED THAT IT WAS MOVING ITS HEAD OFFICE OPERATIONS TO ONTARIO BECAUSE POLICIES RELATED TO THE USE OF FRENCH IN BUSINESS, AND FORCED ENROLLMENT IN THE FRENCH LANGUAGE SCHOOL SYSTEM, MAKE IT DIFFICULT TO ATTRACT ENGINEERS TO QUEBEC.

22. AS MENTIONED PREVIOUSLY, LAGS IN PRIVATE INVESTMENT, UNDER PRIOR GOVERNMENT POLICIES, WERE SIZABLY OFFSET BY MASSIVE PUBLIC WORKS PROJECTS. GIVEN PRESENT ECONOMIC AND FISCAL CONSTRAINTS AND THE ECONOMIC PHILOSOPHY OF THE PQ GOVERNMENT, IT SEEMS CLEAR THE PUBLIC SECTOR CANNOT CONTINUE TO BE COUNTED ON AS A SOURCE OF MAJOR STIMULATION OF THE

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23. THERE ARE ALSO SIGNS THAT THE FINANCIAL INSTITUTIONS ARE TAKING A MUCH HARDER LOOK AT THEIR ACTIVITIES IN QUEBEC. FOLLOWING THE ELECTION OF THE PARTI QUEBECOIS, THE SPREAD BETWEEN PROVINCE OF QUEBEC ISSUES AND ONTARIO ISSUES HAS WIDENED FROM THE NORMAL 30 TO 50 BASIS POINTS TO ABOUT 90 BASIS POINTS. FUTURE FINANCING WILL PROBABLY BE MORE EXPENSIVE FOR QUEBEC AND QUEBEC MUNICIPALITIES, PARTICULARLY IF CONCERN OVER PRESENT DEBT LEVELS, ECONOMIC PERFORMANCE, AND POTENTIAL POLITICAL PROBLEMS SHOULD LEAD TO A REVISION IN THE PRESENT FINANCIAL RATINGS FOR QUEBEC BONDS. WHILE FIGURES VARY WIDELY DEPENDING ON THE SOURCE, TOTAL PUBLIC SECTOR FINANCING IN QUEBEC, INCLUDING THE PROVINCE, MUNICIPALITIES, AND HYDRO-QUEBEC APPROXIMATED \$3.2 BILLION IN 1975, OVER ONE-THIRD OF WHICH WAS FINANCED IN THE U.S. ESTIMATES FOR 1976 PLACE THE TOTAL AT OVER \$4 BILLION, WITH HYDRO-QUEBEC ALONE RAISING MORE THAN \$1.4 BILLION IN U.S. FINANCIAL MARKETS, MORE THAN ANY OTHER SINGLE CANADIAN BORROWER. GIVEN QUEBEC'S DEPENDENCE ON OUTSIDE FINANCING, ANY TIGHTENING OF AVAILABILITIES AND TERMS WILL HAVE IMPORTANT ECONOMIC REPERCUSSIONS.

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24. CURIOUSLY, THE UNITED STATES IS IN A "DAMNED IF WE DO, DAMNED IF WE DON'T" POSITION IN THIS MATTER. IN THE PRESENT EMOTIONAL CLIMATE FEW SEEM INTERESTED IN THE REALITIES OF MONEY TRANSACTIONS, E.G., BEING PRIVATE, NON-GOVERNMENTAL DECISIONS BASED ON PROFITABILITY, AND ONE HEARS SOMEWHAT IRRATIONAL REFERENCES TO "THE U.S. BAILING OUT" THE LEVESQUE GOVERNMENT FROM SOME OF THOSE WHO OPPOSE SEPARATISM. ON THE OTHER HAND, WE CAN EXPECT RISING ANTI-AMERICANISM IF THE TRADITIONAL MARKET FOR QUEBEC'S NEEDS IS EITHER FORECLOSED OR OPEN ONLY UNDER SERIOUSLY DISADVANTAGEOUS TERMS. THESE MIGHT INCLUDE EITHER EXCESSIVE INTEREST RATES OR A POLITICALLY-SENSITIVE QUID PRO QUO SUCH AS THE NEW FISCAL CONSTRAINTS ON MONTREAL ALLEGEDLY DE-

MANDED IN CONNECTION WITH A RECENT \$215 MILLION LOAN CHANNELLED THROUGH THE U.S. FINANCIAL COMMUNITY.

25. LONGER TERM OUTLOOK

THE MAJOR INTANGIBLES IN QUEBEC'S FUTURE AS A RESULT OF THE PQ'S ELECTION RELATE OF COURSE TO THE POSSIBILITY OF SEPARATION, AND THE ATTENDANT REPERCUSSIONS ON THE ECONOMY. SHOULD THE PQ BE MASSIVELY REJECTED IN ITS REFERENDUM, OR DEFEATED IN THE NEXT ELECTION, THE FUTURE OF QUEBEC PRESUMABLY WILL BE SUBJECT TO THE SAME CONSTRAINTS AND PROBLEMS THAT NOW GOVERN IT IN A CANADIAN CONTEXT. UNDER SEPARATION, THE ECONOMIC CONSIDERATIONS THAT QUEBEC MUST TAKE INTO ACCOUNT WILL DIFFER FROM THOSE WHICH IT NOW FACES. THESE CONSIDERATIONS DEAL WITH QUEBEC'S ABILITY TO MAINTAIN A VIABLE ECONOMIC STRUCTURE ONCE OUTSIDE THE CANADIAN CONFEDERATION.

26. THERE ARE THREE BASIC SCENARIOS WHICH QUEBEC COULD FACE FOLLOWING SEPARATION:

- A) INDEPENDENCE, WITH NO PREFERENTIAL MARKET ARRANGEMENTS IN EITHER CANADA, OR THE U.S.
- B) PREFERENTIAL ARRANGEMENTS WITH CANADA.
- C) PREFERENTIAL ARRANGEMENTS WITH U.S.

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27. THERE ARE OF COURSE A NUMBER OF VARIATIONS OF THE ABOVE SCENARIOS, INCLUDING THE DEGREE OF INDEPENDENCE WHICH QUEBEC CHOOSES, OR IS ABLE, TO ATTAIN. A MONETARY AND FISCAL POLICY WHICH CONTINUES TO BE TIED TO OTTAWA WOULD FOR EXAMPLE IMPOSE CONSTRAINTS ON QUEBEC'S ABILITY TO ACT AUTONOMOUSLY IN OTHER AREAS. NONETHELESS, THE ABOVE SCENARIOS CAN BE USED AS MODELS OF THE BASIC CONCEPTUAL APPROACHES TO QUEBEC'S ECONOMIC SITUATION FOLLOWING SEPARATION.

28. THE FIRST OPTION WOULD LEAD TO SEVERE ECONOMIC PROBLEMS FOR QUEBEC. IT IS HARD TO VISUALIZE ANY TYPE OF ARRANGEMENT BEING VIABLE WHICH DOES NOT PROVIDE AN INDEPENDENT QUEBEC WITH PREFERENTIAL ENTRY TO EITHER THE CANADIAN OR U.S. MARKET. AS INDICATED EARLIER, QUEBEC'S PRODUCTION IS MORE DEPENDENT ON EXPORTS TO OTHER PROVINCES THAN IS THE PRODUCTION OF ANY OTHER CANADIAN PROVINCE.

29. GIVEN THE INEFFICIENCIES IN QUEBEC'S ECONOMIC STRUCTURE, INCLUDING SMALL PLANT SCALES, POOR PRODUCTIVITY PERFORMANCE AND RELATIVELY HIGH LABOR COSTS, IT WOULD NOT BE ABLE TO FACE ANY ARRANGEMENT WITHIN THE CANADIAN MARKET LESS FAVORABLE THAN THAT WHICH IT NOW ENJOYS AND STILL PLACE ITS MANUFACTURED PRODUCTS AT A COMPETITIVE PRICE IN OTHER

PROVINCIAL MARKETS. PRIMARY METALS AND RAW MATERIALS WOULD CONTINUE TO BE MARKETED, BUT THE OVERALL IMPACT ON QUEBEC'S ECONOMY WOULD BE SEVERE. MONTREAL'S IMPORTANCE AS A FINANCIAL AND SERVICES SECTOR WOULD DISAPPEAR, LEADING TO GREAT LOSSES IN EMPLOYMENT OPPORTUNITIES; PLANT RUNS WOULD BE EVEN SMALLER AND LESS EFFICIENT; AND LABOR INTENSIVE INDUSTRIES WOULD SUFFER AS CANADA, WITHOUT THE QUEBEC BURDEN, WOULD BE FREE TO TURN TO FAR CHEAPER IMPORT SOURCES.

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30. THE SECOND OPTION IS THE ONE MOST TALKED ABOUT BY THE PARTI QUEBECOIS, WHOSE PRESENT PREFERENCES SEEM TO RUN TOWARD A CUSTOMS UNION WITH THE REST OF CANADA. WHILE SUCH AN ARRANGEMENT WOULD BE BENEFICIAL, INDEED ESSENTIAL, FOR QUEBEC, WOULD THE REST OF CANADA BE INTERESTED? ECONOMICALLY, THERE ARE BOTH PROS AND CONS. MAINTENANCE OF SOMETHING SIMILAR TO THE PRESENT SITUATION WOULD ASSURE CONTINUANCE OF QUEBEC AS A MARKET FOR CANADIAN GOODS, BUT TO A LARGE EXTENT THIS WOULD OCCUR IN THE ABSENCE OF ANY ARRANGEMENT. ECONOMIC COSTS TO CANADA, ON THE OTHER HAND, WOULD BE LARGE. CANADIANS WOULD BE SUBSIDIZING QUEBEC LABOR AND NON-COMPETITIVE INDUSTRY, AND THE PRESENCE OF QUEBEC WITHIN A CANADIAN TRADE ARRANGEMENT WOULD PERHPAS INHIBIT CANADA FROM MOVING TOWARD A RATIONALIZATION OF ITS OWN ECONOMIC STRUCTURE, AS PROTECTED INDUSTRIES COULD HARDLY BE PHASED OUT IN CANADA WHILE THEY CONTINUED TO BE PROTECTED IN QUEBEC.

31. NEVERTHELESS, FOR HISTORICAL AND POLITICAL REASONS, THE REST OF CANADA MAY BE RELECTANT TO CUT QUEBEC COMPLETELY ADRIFT, SO THAT A CUSTOMS UNION REMAINS, IN THE EYES OF THE  
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PQ'S PLANNERS, THE MOST PROMISING ALTERNATIVE FOR AN INDEPENDENT QUEBEC. ESSENTIALLY THE MAINTENANCE OF THE STATUS QUO, SUCH AN ARRANGEMENT WOULD GIVE QUEBEC LITTLE INCENTIVE TO UPGRADE ITS ECONOMIC STRUCTURE. RATHER, IT IS MORE LIKELY THAT EVEN WITH A TRADE ARRANGEMENT WITH THE REST OF CANADA, QUEBEC'S POSITION WOULD CONTINUE TO DETERIORATE, AS AN INDEPENDENT QUEBEC WOULD PROBABLY BE AT A COMPETITIVE DISADVANTAGE IN ATTRACTING NEW INVESTMENT.

32. QUEBEC'S ANSWER TO DOUBTS ABOUT ITS ABILITY TO STAND ALONE IS BASED TO A GREAT DEGREE ON ITS PERCEIVED STRENGTH IN NATURAL RESOURCES. USING NATURAL RESOURCES AS A BASE, QUEBEC WOULD HOPE TO OFFSET ANY LOSSES AS A RESULT OF SEPARATION BY ARRANGEMENTS PROMOTING A MUCH GREATER DEGREE OF PROCESSING OF ITS NATURAL RESOURCES WITHIN THE PROVINCE, IN CONTRAST TO THE PRESENT SITUATION WHERE MUCH OF THE PROCESSING TAKES PLACE OUTSIDE QUEBEC'S BORDERS. ESTABLISHMENT OF PROCESSING FACILITIES WOULD, HOWEVER, REQUIRE HIGH LEVELS OF INVESTMENT. GIVEN QUEBEC'S ECONOMIC OUTLOOK, THE PRESENT HIGH RATES OF TAXATION, AND THE NEW SOCIAL PROGRAMS WHICH THE GOVERNMENT HAS PROMISED ITS SUPPORTERS, IT IS DOUBTFUL THAT SAVINGS WOULD BE ADEQUATE TO FINANCE NEW INVESTMENT. QUEBEC WOULD THEREFORE NEED TO REORDER ITS PRIORITIES TO ALLOCATE FUNDS AMONG COMPETING DEMANDS, OR TURN TO IMPORTS OF FOREIGN CAPITAL, WHICH WOULD RESPOND TO A FAVORABLE PROFIT OUTLOOK, OR HIGH INTEREST RATES. FOR FOREIGN CAPITAL, ASSURANCES OF LARGE MARKETS WOULD BE A NECESSITY, REQUIRING ARRANGEMENTS FOR ENTRY OF PROCESSED GOODS INTO EITHER THE CANADIAN OR U.S. MARKET. UNDER SUCH CIRCUMSTANCES QUEBEC MIGHT HOPE THAT IT WOULD BE ABLE TO NEGOTIATE TARIFF CONCESSIONS IN THE U.S. MARKET IN RETURN FOR ASSURANCES OF RAW MATERIAL SUPPLIES.

33. IF THERE IS AN ECONOMIC GROWTH ARGUMENT FOR SEPARATION, IT RESTS ON THE PREMISE THAT SEPARATION WOULD ALLOW QUEBEC TO RESPOND TO NATURAL MARKET FORCES, BY REORIENTING  
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ITS ECONOMIC TIES TOWARD NATURAL MARKETS IN THE U.S. YET IN VIEW OF THE CONSTRAINTS IMPOSED BY QUEBEC'S PRESENT ECONOMIC STRUCTURE, ANY SUCH REORIENTATION WOULD PROBABLY

NOT BE POSSIBLE WITHOUT A MAJOR RESTRUCTURING OF QUEBEC'S ECONOMY. WHILE FAVORABLE ARRANGEMENTS COULD CONCEIVABLY BE WORKED OUT IN THE CASE OF SOME PROCESSED GOODS ASSOCIATED WITH ASSURED SUPPLIES OF RAW MATERIALS, A MAJOR REORIENTATION OF QUEBEC'S TRADE, PROVIDING ACCESS TO U.S. MARKETS THROUGH REMOVAL OF TRADE BARRIERS, COULD PROBABLY ONLY BE EFFECTED THROUGH MEASURES APPROACHING FREE TRADE ARRANGEMENTS.

34. UNDER SUCH AN ARRANGEMENT, QUEBEC'S RESOURCES DEVELOPMENT WOULD ACCELERATE, INVESTMENT WOULD BE AVAILABLE FOR PROCESSING FACILITIES, AND CERTAIN MANUFACTURING SECTORS, SUCH AS THE PAPER AND CHEMICAL INDUSTRIES, WOULD BENEFIT THROUGH ACCESS TO MUCH LARGER MARKETS, EVENTUALLY PERMITTING ECONOMIES OF SCALE AND AN UPGRADING OF QUEBEC'S MANUFACTURING BASE. THIS IS, HOWEVER, A QUESTIONABLE SCENARIO. THE COSTS TO QUEBEC WOULD BE LARGE, AS A SIGNIFICANT PROPORTION OF QUEBEC'S LABOR FORCE IS EMPLOYED IN LABOR INTENSIVE INDUSTRIES WHICH WOULD NOT BE COMPETITIVE. RESULTING DECLINES IN EMPLOYMENT AND SHIFTS TOWARDS LARGER SIZE ECONOMIC UNITS MIGHT WELL BE UNACCEPTABLE TO A GOVERNMENT WHOSE PHILOSOPHY TO A LARGE EXTENT IS BASED ON THE PROMOTION OF SMALL AND MEDIUM SIZED BUSINESS AND THE PRIMACY OF SOCIAL OBJECTIVES.

35. IN SUMMARY, IT IS DIFFICULT TO SEE HOW AN INDEPENDENT QUEBEC COULD BENEFIT IN ECONOMIC TERMS. WHILE IT IS ARGUED THAT QUEBEC'S MAIN PROBLEM IS UNCERTAINTY, AND THAT THE ECONOMIC SITUATION WILL IMPROVE ONCE THE PERIOD OF INDECISION IS PAST, IT IS ALMOST IMPOSSIBLE TO VISUALIZE A QUEBEC OVER THE FORESEEABLE FUTURE WHERE ECONOMIC DECISIONS COULD BE BASED ON A LIMITED AND PREDICTABLE NUMBER OF ALTERNATIVES. WHILE INDEPENDENCE COULD PROVIDE OPPORTUNITIES FOR RATIONALIZATION OF QUEBEC'S ECONOMIC STRUCTURE IN THE CONTEXT OF

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A LIBERALIZATION OF TRADE BARRIERS, CULTURAL AND SOCIAL CONSIDERATIONS ASSOCIATED WITH PARTI QUEBECOIS PHILOSOPHY WILL PRECLUDE ANY MAJOR MODIFICATIONS WHICH ENTAIL HIGH ADJUSTMENT COSTS. THEREFORE, WHILE THE ECONOMIC ARGUMENT FOR SEPARATION CAN BE MADE ON THE EMOTIONAL BASIS OF HOME OWNERSHIP AND CONTROL, IT IS DOUBTFUL THAT IT CAN BE REALISTICALLY MADE ON THE BASIS OF GREATER RELATIVE ECONOMIC GROWTH. THE ARGUMENT FOR SEPARATION IS THEREFORE ONE WHICH IN ESSENCE IS LARGELY BASED ON NON-ECONOMIC DIMENSIONS.

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